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Ethiopia's Economic Prospects for the 1990s

Paul B. Henze

February 1989

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Ethiopia's Economic Prospects for the 1990s

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February 1989

**Prepared for
The Office of the Under Secretary of Defense
for Policy**

RAND

PREFACE

This Note analyzes the deterioration of key sectors of the Ethiopian economy and projects current trends into the 1990s. It concludes that none of the adverse trends can be reversed in the coming decade without fundamental policy changes by the Marxist-Leninist government of the People's Democratic Republic of Ethiopia (PDRE). Sources for the judgments and projections include PDRE official documents, reports and analyses of Ethiopian and Western scholars and U.S. and international organizations, and the author's own research and observations made during seven visits to Ethiopia since 1977, the most recent in March-April 1988. The Note is based on a paper presented at the Tenth International Ethiopian Studies Conference in Paris in August 1988.

During the past year and a half, the author has been occupied, *inter alia*, in economic research sponsored by the Office of the Under Secretary of Defense for Policy under the auspices of the RAND National Defense Research Institute, a Federally Funded Research and Development Center sponsored by the Office of the Secretary of Defense. This work has been conducted under the International Economic Policy Program as part of a project entitled "Study of the Economy of Revolutionary Ethiopia: Comparative Economic Performance and the Burden of Military Expenditures." While not a formal product of that research, which is being reported in other RAND studies, the present Note reflects portions of it.



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SUMMARY

The 1990s would not be an easy decade for Ethiopia even if the dogmatic Marxist leadership which has dominated the country since 1974 were to shift dramatically to Gorbachevian *glasnost* and *perestroika*. There is no sign of fundamental policy change, however, and without it the current crisis will deepen. The basic fact of population increase overshadows all economic projections. The country's population, growing at 2.9 percent per year, will reach 49 million in 1990 and 65 million in 2000.

A Marxist approach to agriculture has severely limited food production capacity. The current basic food deficit of one million tons annually is likely to rise, even under the most favorable circumstances, to 2.5 million tons by the end of the 1990s. The country has no ability to earn the cost of massive food imports.

Commodity production is likely to remain stagnant. The regime's reliance on coffee as a major export earner at a time of declining world coffee prices and barely increasing global consumption is a measure of desperation. The immediate challenge for the country's leadership is to keep declining export earnings from falling further.

Industrial development is lagging badly. Ethiopia has increased manufacturing output in large part by forced-pace production at the expense of maintenance and capital renewal. Quality has declined. Military requirements appear to have absorbed a major share of increases in light industrial output. Severe shortages of elementary consumer goods will persist. Eritrea still possesses a third of Ethiopia's industrial capacity, but chronic insurgency has prevented its sustained utilization. Restoration and expansion of industry in Eritrea or elsewhere in the country would require large imports of capital from abroad; such imports are unlikely to materialize as long as present policies remain unchanged.

The cost of maintaining the largest standing army in sub-Saharan Africa and continual losses resulting from war operations in the north take much of the Ethiopian budget. Continued large deliveries of Soviet military supplies impose a heavy burden on Ethiopia's own meager revenues, which, in turn, are severely limited because of economic stagnation and decline. As a result, already inadequate education and social expenditures must be further curtailed.

While Ethiopia's gross domestic product (GDP) grew at an average rate of 4.5 percent annually in the last five prerevolutionary years (1969-1973), growth averaged only 1 percent per year during the period 1975-1985. Even this low growth rate may be difficult to

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I. INTRODUCTION

The revolutionary leaders who ousted the imperial regime in Addis Ababa in 1974 promised accelerated modernization through reconstruction of the society on the basis of Marxism-Leninism. During the 1980s, hopes for rapid economic progress collapsed as the country fell victim to recurrent famine and chronic internal rebellions. As of mid-1988, the leaders of the People's Democratic Republic of Ethiopia (PDRE), the official designation of the country since September 1987, have resisted the urgings of both Western and Soviet economists to change economic policies.

This Note analyzes the deterioration of key sectors of the economy and projects current trends into the 1990s. It concludes that none of the adverse trends can be reversed in the coming decade without fundamental policy changes. Negative trends are all likely, in fact, to worsen. It is not too late, however, for *perestroika*, but the longer that is postponed the more difficulty this potentially promising country will have to repair the damage of the past decade and set out on the road to recovery and self-propelled economic growth.¹

Sources for the judgments and projections made in this essay include (1) official PDRE policy declarations, planning documents, and statistical abstracts; (2) studies of Ethiopian specialists and scholars; (3) reports and analyses of international organizations and countries providing emergency relief and/or development assistance to Ethiopia; and (4) Western research. Major sources are listed at the end of this Note and are referenced by number in the sections that follow.

¹I omit consideration of the effect that unexpected discoveries—large deposits of petroleum or rapidly exploitable minerals—could have on the country's economic situation. Fortunate as they would be, such discoveries are unlikely. With the continuation of present economic policies, their full beneficial effect would not be likely to be realized.

II. POPULATION AND FOOD

On the basis of its 1984 census, the PDRE estimated its 1987 population at 45,958,700 [1, p. 22]. The figure is accepted as generally valid by the World Bank and most donor countries. The current rate of increase is considered to be no less than 2.9 percent per year. The World Bank projects a population of 49 million in 1990 and 65 million by the year 2000 [2, p. 274]. Neither PDRE nor foreign officials question this projection [3, p. 1]. Famine and war have had little effect on population growth. A decisive improvement in health standards resulting in an increase in Ethiopia's low life expectancy (45 in 1985) and reduction of its high infant mortality (168 per 1000 in 1985) [4, p. 258] would raise the rate of increase substantially.¹

From 1980 onward, per capita production of grain in Ethiopia steadily declined. Some 6,200,000 MT of grain equivalent were estimated as the country's annual average production for the five years 1979-1983. During the same period, a population under 40 million consumed an annual average of 6,550,000 MT, leaving a "normal" annual deficit of 350,000 MT [5, pp. 1-3]. During the two years of the first great famine, 1984-1985, grain imports totaled 1,492,000 MT [6, p. 190; 4, p. 212]. In early 1987, Ethiopia's normal consumption needs for a population of 45.6 million were estimated at 7,413,000 MT, with a "normal" production deficit of 884,000 MT [7, pp. 3ff.].

Total grain production for 1987 declined, however, by approximately 15 percent from the previous year, to 4,877,000 MT [8, p. 2]. To increase food availability to 2000 calories per day (the 1985 level was 1681 [4, p. 260]) for the 1994 population, PDRE officials estimated that total food production will have to increase at a rate of 6.5 percent yearly. They made this objective a policy goal [3, pp. 2-6; 9, p. 22]. It is unattainable.

A U.S. evaluation of grain production prospects made in early 1988, which took into account the anticipated positive effect of modest policy adjustments to provide incentives for improved production and marketing, concluded:

¹In developed economies population size and rate of growth are only incidental factors affecting medium-term economic prospects. In developing countries all economic projections must take population statistics directly into account, for the ability of the country to feed itself or to earn the funds necessary to cover food imports is of primary importance.

Total [grain] production cannot be expected to rise above the pre-drought levels until 1990 or later when development programs being initiated become operative and increases in yields resulting from increased inputs can be attained.... With a population of over 50 million projected for 1990, a shortfall of up to 2 million tons a year could develop [8, pp. 14-15].

Even a best-case estimate that combines the most optimistic assumptions of Ethiopian and foreign specialists depicts a drastic and worsening grain problem. Assuming the restoration of grain production to a level only slightly below the average pre-1985 level by 1990 and projecting a sustained 3 percent annual increase through the 1990s with 2.9 percent population growth, the estimate is as follows (in MT):

	Production	Requirement	Deficit
1990	6,000,000	8,044,000	2,044,000
1995	6,956,000	9,263,000	2,307,000
2000	8,064,000	10,563,000	2,499,000

For that matter, *deficits twice as large as those projected above* could occur as the result of continuing policies that aim at ultimate total "socialization" of agriculture [9, pp. 16, 25; 10, pp. 46-47; 11, pp. 258ff.], inhibit short-term incentives to produce and sell, and continue to allocate disproportionate resources to the least productive sector of the agricultural economy (state farms), combined with adverse natural and security conditions. At a minimum, Ethiopia will have to find means of covering a shortfall of two to two-and-one-half million tons of grain through the 1990s. To date, Ethiopia has relied on international charity. Can it continue to do so indefinitely? Will it ever be able to pay for a portion of its grain requirements with export earnings?

III. COMMODITY PRODUCTION AND EXPORT EARNINGS

While Ethiopia's imports increased 65 percent during the years 1977-1984,¹ exports fell steadily and the trade gap had widened to more than half a billion dollars annually by 1984 [12, p. 29]. A World Bank assessment of Ethiopia's export potential in the mid-1980s concluded:

[T]he value of imports has been running more than double that of merchandise exports since 1981/82. The external current account deficit has widened to reach 6.8 percent of GDP while total external debt service has risen to more than 27 percent of exports of goods and services in 1985/86. Since a more rapid pace of investment and development would require increasing imports, the emerging current account deficit and debt service burden will become unsustainable before long unless there is vigorous development of exports and import substitutes [13, p. i].

Coffee has long been a prime Ethiopian export. During the years before 1974, it usually accounted for somewhat more than one-third of total exports by value. Live animals and animal products, pulses, and oilseeds were other major exports. Private entrepreneurs, encouraged by the government, made energetic efforts to develop exports of fresh fruits and vegetables and products of light industry, especially from Eritrea. In the ten years following the revolution, pulse and oilseed exports declined from 200,000 MT to 45,000 MT annually. Exports of canned and frozen meat fell by 80 percent and fruits and vegetables by 50 percent [13, p. 6]. Like several other aspects of the Ethiopian economy, trade in live animals has gone "underground." Some 225,000 head of cattle, 750,000 goats and sheep, and 100,000 camels were estimated to be going across Ethiopia's borders illegally in 1986 [13, p. iii].

PDRE officials found themselves forced to rely on coffee as the major source of export income with the result that by the mid-1980s coffee accounted for almost two-thirds of the country's declining export earnings. There were many inconsistencies in regime coffee policy. Coffee was subject to an increasingly heavy surtax. State farms, though accounting for only a small proportion of coffee production and chronically operating at a loss, were favored over small peasant producers, who were nevertheless able to produce at a small profit [14, p. 96].²

¹Exclusive of military equipment and supplies and emergency famine relief, both also consistently high.

²According to the 1983 FAO *World Coffee Survey*: "Coffee is mainly a

Restrictions on the hiring of labor decreed in 1975 forbade previous seasonal migration of workers from the central highlands to the coffee-growing regions in the southwest and combined with rigid price controls to discourage the gathering of coffee for the official market. Under European Community (EC) pressure, the PDRE made minor concessions to peasant producers in 1987 [15, pp. 17-18]. The Soviet GOSPLAN advisory group summed up the incongruities of PDRE coffee pricing in its critical 1985 review of the Ethiopian economy:

[T]he present producer price of 1 ton of coffee is 2593 birr, whereas the procurement price is 1747 birr, or 32.6% less, but the export price of unwashed coffee is 6065 birr. On the other hand, the price of roast coffee in the private...sector is 17 birr per kilogram, or 17,000 birr per ton [16, p. A.83].³

It is little wonder that the PDRE has never achieved its target of 100,000 MT of coffee exports. Exports fell from 87,000 MT in 1984 to 73,000 MT in 1986, and the volume is believed to have subsequently dropped still further as illicit trade in coffee has grown, despite expanded controls. Both Djibouti and Somalia, which produce no coffee, have been exporting it.

In world markets, coffee has long been in oversupply and prices have been declining [14, p. 127]. Even with pricing concessions and other measures to encourage production and processing, Ethiopia will do well in the 1990s if it is able to ensure average annual income from coffee exports at the best level attained during the 1980s. Reliance on coffee as a major source of export income is a measure of desperation.

Does Ethiopia have any prospects for new exports? To the surprise of some observers, resettlement areas in the west and southwest of the country are already producing a surplus of field corn (maize). By early 1988, the oversupply had reached the point where the Agricultural Marketing Corporation stopped purchases and the open market price fell to a fraction of the official price. The potential for substantial increases in corn production appears high. But most Ethiopians do not consume corn directly as food, and the country

smallholders' enterprise. Of all the countries analyzed, more than half grow coffee exclusively on small holdings. In several countries due to shortage of labor and ever increasing wages, coffee estates have been abandoned in favor of medium and small units. This trend is likely to continue" [quoted in 14, p. 25].

³One U.S. dollar equals 2.07 Ethiopian birr at the official rate of exchange; the unofficial rate fluctuated between 4 to 4.65 birr to the dollar in early 1988.

lacks the technology to process it into animal and poultry feed or oil, syrup, starch, and palatable manufactured food products. Transport costs to ports would currently exceed return from export sales. A sizable proportion of the country's new corn production may therefore deteriorate in storage.

No conceivable increase of commodity exports in the 1990s could provide sufficient return to make a significant contribution to the cost of grain imports. The immediate challenge for PDRE leaders at the beginning of the 1990s is to keep export earnings from falling further.

IV. INDUSTRIAL DEVELOPMENT

Marxism glorifies heavy industry, for industrial workers theoretically form the political base of a "people's democracy" and industrial expansion is a high priority for any Marxist-Leninist leadership. Industrial production accounted for 9.3 percent of Ethiopia's GDP in 1974 [17, p. i] and increased to 16 percent by 1985 [4, p. 206], a gain of 0.6 percentage point per year. The actual pattern of growth was spotty, with some nationalized medium- and large-scale industries producing well and small-scale industry and handicrafts generally stagnating. Except for a few Soviet and East European projects (e.g., a tractor assembly plant at Nazareth and two breweries and a malt factory), little new industry has been built in Ethiopia. Most efficient performance has come from corporations established before the revolution, some of them always state-controlled and others originally private and now nationalized, such as sugar. The most successful enterprises preserve a substantial degree of Western-style management.

The country's single most profitable corporation is Ethiopian Airlines, which not only serves a wide network of domestic and international routes but also provides training and maintenance services for more than a dozen other African and Middle Eastern airlines [18]. While the airline has guarded its independence from PDRE bureaucracy and begun the manufacture of light planes, it has not been permitted to expand into fields such as hotel construction and management, tourism, and catering. These fields have been reserved for inefficient new state corporations which operate at a loss.

Increases in output of manufactures have been achieved in large part by forced-pace production at the expense of maintenance and capital renewal. Quality has declined. A major share of increases in textile, shoe, food, and other light industrial output appears to have been absorbed by the military forces. Severe shortages of elementary consumer goods have become chronic. Eritrea still accounts for a third of Ethiopia's total industrial capacity, but war in the north has repeatedly interrupted production and hindered maintenance. In spite of continued efforts since the early 1980s to attract foreign investment for joint ventures, none has materialized.

The leaders' and planners' bias against surviving private entrepreneurs has discouraged investment in small-scale industry, especially in the provinces. Such undertakings could satisfy acute needs for vehicle and machinery repair, construction materials, farm implements, elementary processing of agricultural produce, production of

consumer durables, and household goods. Small- and medium-scale hydropower installations would be valuable in many parts of the country, for Ethiopia has enormous untapped water resources. Development of new hydropower has been concentrated on a single large Soviet-supported project in the southeast, which has been behind schedule.

Soviet advisers have joined Western specialists in criticizing shortcomings in management and performance of nationalized industry, failure to employ working capital effectively, overstaffing, and delay in repair and installation of equipment [16, pp. A.23-A.28]. Though Ethiopian industrial performance in fields such as sugar, textiles, food processing, construction, power generation, and telecommunications was rated high by Third World standards before the revolution, the trend under Marxism-Leninism has been downward to the level of "communist planned inefficiency" so devastatingly exposed in a recent book by Polish economist Jan Winiecki and described now almost daily in the Soviet press [19].

None of the goals outlined by the World Bank in 1984 even in its low-growth scenario for Ethiopia appears likely to be attained by the end of the 1980s [20, pp. 57-58]. Prospects for increases in production from the present inadequate industrial base are poor. The expansion of industry will require large investments which, given basic worldwide trends, donors are unlikely to provide for most nationalized industries. New capital equipment must be imported and cannot, even under the most favorable circumstances, be expected to have a positive impact on the balance of payments for three to four years.

V. MILITARY OUTLAYS VERSUS EDUCATION AND SOCIAL SERVICES

Though seldom highlighted or stressed (and sometimes ignored) in official PDRE documents and statements, the costs of maintaining the largest standing army in sub-Saharan Africa and replacing the continual losses resulting from war in the north and security operations in many other parts of the country weigh heavily on the PDRE budget. The starkest summary of their effect may be found in the turgid bureaucratic language of the Soviet GOSPLAN advisers' report to the PDRE Central Planning Commission:

The principal cause of such high growth rates of recurrent public expenses...was the objective need for a considerable expenditure enhancement [increase] for defense, state security, [and] justice, as dictated by the Somali war of aggression as well as by the presence of secessionist and counterrevolutionary forces. The outlay for these purposes grew from 294.9 million birr in 1973-1974 to 1264.3 birr in 1983-1984, i.e., more than 4-fold. The share of these expenses in total recurrent public expenditures increased from 49.2% in 1973-1974 to 59.1% in 1983-1984 [16, p. A.76].

Though military expenditures alone had begun to decline as a proportion of the national budget in the mid-1980s (from a high of 38 percent in 1980 to 28.8 percent in 1984 [12, p. 26]), they are rising sharply as a result of the emergency national mobilization decreed in March 1988 to counter the successes of the Eritrean and Tigrean insurgents. Without massive Soviet deliveries of arms, ammunition, and other military equipment, the PDRE would lack the means of maintaining military forces of any size or effectiveness. Since late 1977, these deliveries have approached a total of \$10 billion in 1984 constant U.S. dollars [21, pp. 100, 127]. These arms supplies are by no means cost-free: To use the weapons, the Ethiopian government must allocate large sums from its own meager revenues to cover the costs of maintaining a large, standing army. Even with continued Soviet arms resupply at a level exceeding \$500 million per year and great sacrifices on the part of the Ethiopian population, no military solution to the northern insurgencies and other problems of regional dissidence is in sight.

Meanwhile, resources to sustain the meager level of progress in educational, health, and other social programs so far attained are steadily contracting. Already the PDRE is curtailing the expansion of education, even though in 1983 only 46 percent attended school at the primary level and 13 percent at the secondary level [12, p. 22]. The government is

forced to limit annual entrance to higher education to no more than 2 percent of those who take the annual university entrance examinations. The training of health-service personnel is lagging, and there are severe shortages of simple drugs and elementary medical supplies. With the costs of unending war, it will be difficult to avoid a decline in the current level of expenditure for education and social services in the 1990s.

VI. CONCLUSIONS

Both PDRE spokesmen and Soviet economists have habitually attributed the country's economic shortcomings to

inherited backwardness, a low development level of productive forces, complexities emanating from a subordinate position...in the international capitalist market...the struggle against external and internal reactionary forces, recurring drought...[16, p. A-4].

These threadbare rationalizations bypass the fundamental issue of economic philosophy, policy, and tactics pursued to achieve accelerated development. They ignore the fact that all these negative constraints were operative before 1974. Nevertheless, Ethiopia's GDP grew at an average rate of 4.5 percent per year during the five years 1969-1973, reaching a peak of 6.8 percent in 1970. GDP growth averaged only 1.85 percent annual growth during the first ten years of Ethiopian socialism and fell by 7.4 percent in 1985 as a result of the first great famine. *Average* GDP growth for the 11 years 1975 through 1985 was thus only one percent per year. It may again be turning negative in 1988.

Though agriculture, which accounts for almost half of Ethiopia's GDP, began to recover in 1986-1987, drought and war resulted in severe threat of famine again in 1987-1988. However, as Kenya's experience in 1984-1985 demonstrates [12, pp. 17-21], drought need not automatically lead to famine. Respected Ethiopian researchers have shown that Ethiopian peasants and pastoralists evolved strategies through the centuries for coping with adverse natural conditions [11, 22, 23]. Their capacity to do so is being undermined by villagization. Resettlement, a desirable concept, has been implemented by coercion and with ideological biases that make it unlikely that resettlement projects, under present restrictions, will soon develop self-sustaining dynamism [10, pp. 46-47].

In the broader sense, ill-considered and arbitrarily implemented government policies lie at the root of famine, economic nondevelopment, and deepening systemic crisis in Ethiopia. Even if PDRE leaders could be excused for failing to understand in 1974, when they chose Marxism-Leninism as the basis for development, that it was a failed system, they cannot be forgiven for adhering stubbornly to unworkable policies in the face of what has been admitted (and in part changed) in the USSR, Eastern Europe, and China during the past several years. Marxism-Leninism does not work. *Glasnost* and *perestroika* may not

generate permanent solutions for what Brezhnev called "developed socialism" and what the Soviets now refer to as "the period of stagnation," but they offer promise as the first step in evolution toward recovery.

The only real solution to the degeneration that afflicts the Ethiopian economy is to introduce real economic incentives, restore a free market, reward initiative and enterprise, and thus set the country back on the path to development of an open society. Even to a greater extent than much of Africa, Ethiopia is moving in the opposite direction. The internal wars on which PDRE leaders continue to waste the blood of Ethiopian youth (and the arms which the Soviets keep delivering) are not inescapable acts of fate. They too are the cumulative result of wrong political decisions.

If leaders in Addis Ababa were creating conditions for rapid economic growth, a rising standard of living, and an open society in which Ethiopians could exercise their talents for enterprise and self-expression, insurgents and dissidents would lose their popular base. However stubbornly a few rebel leaders might want to keep fighting, the majority of Eritreans and Tigreans would take advantage of an opportunity to play a major role in a vigorously developing Ethiopian state that could become a model of prosperity for the entire region. Marxism-Leninism cannot produce this result. Under Marxism-Leninism, bureaucracy mushrooms, corruption flourishes, development lags, ethnic and regional tensions grow, and what remains of productive economic activity takes place underground.

The 1990s will not be an easy decade for Ethiopia under the best of circumstances. Unless the present disastrous course is reversed, the country may disintegrate.

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